

**Supplemental Letter of Findings: 09-0737**  
**Financial Institutions Tax**  
**For the Years 2005, 2006, and 2007**

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**ISSUE**

**I. Financial Institutions Tax – Unitary Business.**

**Authority:** IC § 6-5.5-1-17; IC § 6-5.5-1-18; IC § 6-5.5-2-1; IC § 6-5.5-3-1; IC § 6-5.5-5-1; IC § 6-8.1-5-1; [45 IAC 17-2-6](#); [45 IAC 17-2-8](#); [45 IAC 17-2-9](#); [45 IAC 17-3-2](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the exclusion of a subsidiary from its FIT combined returns.

**STATEMENT OF FACTS**

Taxpayer and its subsidiaries conduct the business of financial institutions, which provide various financial products, including, but not limited to, personal financial services, consumer finance, credit cards, commercial banking, private banking and corporate investment banking. The Indiana Department of Revenue ("Department") conducted an audit of Taxpayer's amended combined returns for 2005-2007 Financial Institutions Tax (FIT). As a result, the Department determined that several entities, including, but not limited to, Company A (for years 2005, 2006, and 2007), Company B (for year 2006), and Company C (for years 2005 and 2006), were not transacting business within Indiana and, therefore, their income and/or losses for those years should be excluded from Taxpayer's amended combined returns, which resulted in an additional tax.

Taxpayer protested the additional assessment. Specifically, Taxpayer believes that Company A, B, and C were transacting business within Indiana for FIT purposes during those years and, thus, Taxpayer's combined returns should include their income and/or losses for those years.

A hearing was held. Letter of Findings Number 09-0737 ("LOF"), sustained Taxpayer's protest in part, concluding that Company B (for year 2006) and C (for years 2005 and 2006) were transacting business within Indiana. The LOF, however, found that Company A was not transacting business within Indiana and, therefore, was properly removed from Taxpayer's Indiana combined returns for those years.

Subsequently, Taxpayer submitted additional documentation and requested a rehearing. The rehearing was granted based on the additional documentation concerning Company A. This Supplemental Letter of Findings ensues. Additional facts will be provided as necessary.

**I. Financial Institutions Tax – Unitary Business.**

**DISCUSSION**

The LOF determined that Company A was not transacting business within Indiana pursuant to IC § 6-5.5-3-1. Taxpayer, to the contrary, on rehearing stated that Company A sold Retail Internotes to individuals within Indiana through a wholesale distributor's underwriting and its broker/agent network thus subjecting Company A to FIT. Thus, Taxpayer maintained that Company A was transacting business within Indiana and, therefore, its amended combined returns should include Company A's income and/or losses for those years.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a financial institution tax pursuant to IC § 6-5.5-2-1(a), as follows:

There is imposed on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising its franchise or the corporate privilege of **transacting the business of a financial institution in Indiana. (Emphasis Added).**

IC § 6-5.5-1-17, in relevant part, provides:

(a) "Taxpayer" means a corporation that is **transacting the business of a financial institution in Indiana**, including any of the following:

- (1) A holding company.
- (2) A regulated financial corporation.
- (3) A subsidiary of a holding company or regulated financial corporation.
- (4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution.

...

(d) For purposes of this section and when used in this article, "business of a financial institution" means the following:

- (1) For a holding company, a regulated financial corporation, or a subsidiary of either, the activities that

each is authorized to perform under federal or state law, including the activities authorized by regulation or order of the Federal Reserve Board for such a subsidiary under Section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)), as in effect on December 31, 1990.

(2) For any other corporation described in subsection (a)(4), all of the corporation's business activities if eighty percent (80%) or more of the corporation's gross income, excluding extraordinary income, is derived from one (1) or more of the following activities:

**(A) Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include:**

- (i) secured or unsecured consumer loans;**
- (ii) installment obligations;**
- (iii) mortgage or other secured loans on real estate or tangible personal property;**
- (iv) credit card loans;**
- (v) secured and unsecured commercial loans of any type;**
- (vi) letters of credit and acceptance of drafts;**
- (vii) loans arising in factoring; and**
- (viii) any other transactions with a comparable economic effect.**

**(B) Leasing or acting as an agent, broker, or advisor in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes.**

**(C) Operating a credit card, debit card, charge card, or similar business.**

As used in this subdivision, "gross income" includes income from interest, fees, penalties, a market discount or other type of discount, rental income, the gain on a sale of intangible or other property evidencing a loan or extension of credit, and dividends or other income received as a means of furthering the activities set out in this subdivision. **(Emphasis added).**

Thus, the Indiana General Assembly outlines certain business activities which are considered transacting the business of a financial institution in Indiana.

[45 IAC 17-3-2](#)(b), in relevant part, states "[i]f the taxpayer is a member of a unitary group as defined in [45 IAC 17-3-5](#), combined reporting is mandatory, unless [IC 6-5.5-5-1](#)(b) is applicable." IC § 6-5.5-1-18(a) further defines "unitary business" and states:

"Unitary business" means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. The term may be applied within a single legal entity or between multiple entities and without regard to whether each entity is a corporation, a partnership, a limited liability company, or a trust, provided that each member is either a holding company, a regulated financial corporation, a subsidiary of either, a corporation that conducts the business of a financial institution under [IC 6-5.5-1-17](#)(d)(2), or any other entity, regardless of its form, that conducts activities that would constitute the business of a financial institution under [IC 6-5.5-1-17](#)(d)(2) if the activities were conducted by a corporation. The term "unitary group" includes those entities that are engaged in a unitary business transacted wholly or partially within Indiana. However, **the term does not include an entity that does not transact business in Indiana. (Emphasis added.)**

Accordingly, only when Company A's activities satisfy as transacting the business of a financial institution and was transacting the business of a financial institution within Indiana for those years, should Company A be included in Taxpayer's FIT combined returns.

To determine whether a taxpayer is transacting business within Indiana, IC § 6-5.5-3-1 provides:

For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:

- (1) maintains an office in Indiana;
- (2) has an employee, representative, or independent contractor conducting business in Indiana;
- (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
- (4) regularly solicits business from potential customers in Indiana;
- (5) regularly performs services outside Indiana that are consumed within Indiana;
- (6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;
- (7) owns or leases tangible personal or real property located in Indiana; or
- (8) regularly solicits and receives deposits from customers in Indiana.

[45 IAC 17-2-6](#) further illustrates:

(a) A taxpayer is transacting business within Indiana if the taxpayer has activities which include any of the following:

- (1) Maintains an office in Indiana by establishing a regular, continuous, and fixed place of business in this state.

(2) (A) Has an employee, representative, or independent contractor conducting business in Indiana evidenced by such persons regularly acting on behalf of the taxpayer in furthering the business of a financial institution, as defined in section 3 of this rule ([45 IAC 17-2-3](#));

(B) both the office from which such person's activities are directed or controlled is located in Indiana and the majority of such person's services are conducted on behalf of the taxpayer in this state; or

(C) a contribution to the Indiana employment security fund is required under [IC 22-4-2](#) with respect to compensation paid to the employee.

(3) Owns or leases to customers real or tangible personal property if the property is physically situated in this state. Mobile tangible personal property is deemed to be located in Indiana if:

(A) such property is operated entirely in Indiana or is only occasionally operated outside this state; or

(B) the principal base of operations from which the property is sent out is in Indiana or there is no principal base of operations and Indiana is the commercial domicile of the lessee or other user of the property.

(4) Regularly solicits business from potential customers in Indiana.

(5) Regularly solicits and receives deposits from Indiana customers in Indiana. Deposits are attributed to this state if they are deposits made by this state or residents, political subdivisions, or agencies and instrumentalities of this state regardless of whether the deposits are accepted or maintained by the taxpayer at locations within Indiana.

(6) Regularly sells products or services of any kind or nature to Indiana customers in Indiana that receive the product or service in Indiana.

(7) Regularly performs services outside Indiana that are consumed within Indiana.

(8) Regularly engages in transactions with Indiana customers that involve intangible property, including loans, but not property described in section 7 of this rule ([45 IAC 17-2-7](#)) and result in receipts flowing to the taxpayer from within Indiana.

(b) For purposes of this article ([45 IAC 17](#)), "regularly", when applied to any business activity, depends on the number of transactions, and with respect to any transaction, its size and complexity and whether it involves one (1) act or a series of activities to be performed over a substantial time period, and the extent to which any transaction or transactions involve the protection by the laws, government, or public institutions of the state of Indiana. The following are examples:

(1) A corporation which operates a credit card or charge card business and executes a contract with cardholders enforceable in Indiana which is evidenced by one (1) or more of the following: billed to cardholders in Indiana, providing interest on any amount due until paid, providing a card which operates as a form of money for purchasing material and services in Indiana, or establishes contracts with the Indiana vendors.

(2) A regulated financial corporation receiving deposits and making loans in Indiana, operated through mail, telephone, or automated terminals in Indiana with computer generated or other record keeping and billing outside Indiana.

(3) A regulated financial corporation providing an Indiana based corporation with a line of credit with complex credit requirements and supervision.

(4) A construction loan in Indiana requiring many draws and substantial inspection and certification over a period of time in Indiana.

In this instance, Taxpayer maintained that Company A, through a wholesale distributor's broker/agent network, sells Retail Internotes to individuals, including Indiana residents. Taxpayer further asserted that, pursuant to [45 IAC 17-2-9](#), Company A is presumed to "regularly solicit business within Indiana" because Company A's Retail Internotes generated at least five million dollars or more of deposits with Indiana residents or had twenty or more "Indiana customers." Taxpayer stated:

The Retail Internote product allows [Company A] to borrow from "mom and pop" customers at a relatively low interest rate. Retail Internote customers can deposit funds with their broker in increments of \$1000 with a holding period that can range from as little as one year to five years or more. Retail Internotes have the full faith and credit of the financial institution issuing them, but they are not insured by the FDIC. Retail Internote customers do not receive a certificate from [Company A or Taxpayer] (or any other Retail Internote issuer). Instead, the customer's brokerage account reflects an investment in the Retail Internote, which can be identified by CUSIP numbers and other identifiers.

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Retail Internotes include a "death put" option. If a Retail Internote customer dies, the customer's estate has the right to exercise the "death put" option and receive a 100 [percent] of principle.

To support its protest, Taxpayer submitted a copy of the Selling Agent Agreement and sample copies of the Survivor's Option (Repayment) Election Forms, which documented the fact that some of the customers' estates exercised the "death put" option.

[45 IAC 17-2-8](#) defines "soliciting business," as follows:

A taxpayer is not required to be physically present within Indiana to be soliciting business. Soliciting business

includes, but is not limited to, the following:

- (1) The distribution, by mail or otherwise, of catalogs, periodicals, advertising flyers, or other written solicitations of business to potential customers in Indiana, without regard to the state from where the distribution originated or where the materials were prepared.
- (2) Display of advertisements on billboards or other outdoor advertising in this state.
- (3) Advertisements in newspapers published in this state.
- (4) Advertisements in trade journals or other periodicals, the circulation of which is primarily within this state.
- (5) Advertisements in an Indiana edition of a national or regional publication or a limited regional edition of which this state is included as part of a broader regional or national publication, and which are not placed in other geographically defined editions of the same issue of the same publication.
- (6) Advertisements in regional or national publications in an edition which is not by its contents geographically targeted to Indiana, but which is sold over the counter in Indiana or by subscription to Indiana residents.
- (7) Advertisements broadcast on a radio or television station which are received by Indiana residents.
- (8) Any other solicitation by telegraph, telephone, computer data base, cable, optic, microwave, or other communication system.

[45 IAC 17-2-9](#) outlines a rebuttable presumption that a taxpayer is presumed to regularly solicit business within Indiana, as follows:

A taxpayer is presumed, subject to rebuttal, to regularly solicit business within Indiana during a taxable year if at any time during the taxable year, the sum of the taxpayer's assets, including the assets arising from loan transactions, and the absolute value of the taxpayer's deposits attributable to Indiana, equal at least five million dollars (\$5,000,000), or if the taxpayer does any of the following during the taxable year:

- (1) Sells products or services of any kind or nature to twenty (20) or more Indiana customers who receive the product or service in Indiana.
- (2) Solicits business from twenty (20) or more potential Indiana customers.
- (3) Performs services outside Indiana that are consumed within Indiana by twenty (20) or more customers.
- (4) Engages in transactions with twenty (20) or more Indiana customers that involve intangible property, including loans, but not property described in section 7 of this rule ([45 IAC 17-2-7](#)) and result in receipts flowing to the corporation from such customers within Indiana.

However, if a taxpayer is presumed to be regularly soliciting business in Indiana, but its total activities in Indiana fall within the exempt activities identified in section 7 of this rule ([45 IAC 17-2-7](#)), the taxpayer is not subject to the FIT.

Assuming that Taxpayer demonstrated that it had at least twenty individuals within Indiana who "purchased" its Retail Internotes via brokerage firms and the total amount was greater than five (5) million dollars during each taxable year, Taxpayer, nonetheless, failed to demonstrate that its "sales of the Retail Internotes," qualified as transacting the business of a financial institution pursuant to the above mentioned FIT statute and regulations.

In this instance, Taxpayer argued that its Retail Internotes were similar to certificates of deposit (CDs) offered by financial institutions. Its Retail Internotes, however, were not insured by the Federal Deposit Insurance Corporation (FDIC). Additionally, the Internotes were available for sale only through investment brokerage companies and there were no certificates to record their deposits. Instead, the records were maintained by the investment brokerage companies, which periodically updated individual account balances. Moreover, Taxpayer's Prospectus Supplement, dated December 17, 2008, stated that the Internotes were "debt securities" under an indenture between Company A and a trust company. Taxpayer, at the rehearing, explained that, on its balance sheet, Company A recorded the money it received from the sales of the Internotes as a "liability" and the "interest," which Company A paid to the individuals, who acquired its Retail Internotes, as an "expense." Thus, Taxpayer's sales of its Retail Internotes were, at best, a means of raising capital and the equivalent of selling corporate bonds, where the investors assumed the risks of their investment, to finance Taxpayer's business operation. Given the totality of the circumstances, in the absence of other documentation, the Department is not able to agree that, pursuant to [45 IAC 17-2-9](#), Taxpayer's sales of its Retail Internotes was to solicit business within Indiana for FIT purposes.

In short, Taxpayer failed to meet its burden of proof demonstrating that Company A was transacting business within Indiana. Thus, the Department's audit properly removed Company A from Taxpayer's FIT combined returns for those years.

### FINDING

Taxpayer's protest on Company A is respectfully denied.

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